STATE OF MUNICIPAL FINANCES IN INDIA AND THE ISSUE OF DEVOLUTION: A NOTE

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NO.4 JANUARY, 1991

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I. Introduction : State of Municipal Services and Municipal Finances

It is common knowledge that municipal services in India are in an awaful State. According to a recent survey of 157 municipalities, out of a total of some 2000 in the country, carried out by the National Institute of Urban Affairs (NIUA) as of 1986-87, on an average, municipal bodies spend Rs. 143 per capita on the operation and maintenance of various services. This is far below the norms proposed long ago by the Zakaria Committee (Rs. 205 at 1986-87 prices). Of the 157 municipalities surveyed, only 24 have expenditure levels at par or higher than the Zakaria norms. In 73 municipalities, (about 47 per cent of the sample) the expenditure levels were less than Rs. 100. The levels are particularly low for water supply and sanitation (sewerage, drainage and refuse collection) - Rs 47 as against a norm of Rs. 126 per capita, that is, less than 40 per cent of the norm. The situation is almost the same for medical and health services.

In physical terms too, the services fall far short of the norms. In 68 per cent of the municipalities surveyed, per capita levels of water supply are much below the Zakaria Committee norms. About one-fourth of the urban population has no access to safe water supply and these averages conceal considerable inter-State and intra-State variations. Of the 157, as many as 109 have no sewerage system. Even within those which have, 80 per cent of the population are not covered. The drainage systems too cover only 2/3rds of the population of the sample municipalities. Their performance in the matter of refuse collection and disposal is equally dismal.

The main factor which appears to be responsible for the situation is the poor state of municipal finances. The principal own sources of revenue available to the municipalities do not seem to be at all elastic or elastic enough while expenditures keep growing, widening the gap between own income and expenditure and thereby increasing their dependence on grants from the respective State Governments. According to another study by NIUA, between 1979-80 and 1983-84, "ordinary incomes" of the municipalities grew by 9.7 per cent while their "ordinary expenditures" multiplied by over 56 per cent. As of 1986-87, the gap between own revenue and expenditures of the municipalities was of the order of 30 per cent of the total amount of expenditures. The proportion of own source revenue in the total revenue of the municipalities is of the order of 68 per cent, the rest of the gap being met out of grants, taxes and "other sources" like borrowing, etc. (vide Table 1). All available evidences show that the gap has been increasing. From the NIUA samples, it would appear that proportion of external sources in the municipal income has increased from 13 per cent in 1975-76 to 25 per cent in 1979-80 ~~1989-90~~ and 32 per cent at present (1986-87). In West Bengal, the gap between own revenue and current expenditures as a proportion of total revenue expenditure of municipalities has gone up from 22 per cent in 1965-66 to 31 per cent in 1975-76 and 58 per cent in 1984-85 (Table 2). According to the NIUA survey again, the estimated revenue gap of the municipalities of the Zakaria Committee norms to be attained, works out to 117 per cent of the current revenue. In Assam current revenue would have to go up by as much as 1742 per cent just to meet these norms. For Bihar, the gap is 946 per cent, Kerala 225 per cent, Rajasthan 160 per cent, Tamil Nadu 122 per cent, Uttar Pradesh 158 per cent and West Bengal 310 per cent. By the year 1994-95, the gap would increase to staggering proportions (Table 3).

II. Suggested Remedies: The Case for Autonomy and Devolution

With rapid growth of urban population, the deterioration in the levels of municipal finances has naturally been a matter of great concern to planners and policy makers in the country. Various remedies have been explored to improve the situation. One move has been on the part of the State governments to take over some of the functions of the municipalities (like primary education and part of the responsibilities for health care). Weaknesses of the municipal administration have impelled some States to take over some of the tax powers which were earlier assigned to the municipal bodies. But by and large, the weaknesses persist. Barring a few, the municipalities do not inspire any confidence that they would be able to cope with the problems which they are facing and which they were facing and which are multiplying rapidly. They have neither the powers nor the capability to deliver what is required of them.

One widely shared view is that the policy of taking over the powers and functions of the municipalities has been wrong. According to this school, if the municipalities are finding it difficult to cope with their problems, it is largely because they have been crippled over time in the matter of resources and the fiscal powers they have at their disposal are too meagre to enable them to meet their financial needs. Most of the elastic sources of revenue are either with the Centre or with the States. While the States where some of the powers of taxation have been taken away, arrangements have generally been made for sharing of the avenues from the taxes so taken over. However, there is no institutional arrangement for the devolution of funds to the municipalities. Flow of funds from the States or other agencies is erratic and cannot be depended upon by the municipalities for firm budgeting. Only one or two States like Gujarat and West Bengal have attempted to evolve something like a grants formula or set up a Municipal Finance Commission but those efforts do not seem to have taken off or yielded significant results.

The root cause of this state of affairs, according to some including experts, is that the urban bodies have no separate status or recognition under the Indian Constitution and they are left completely at the mercy of the State governments in the matter of their administration and finances. Not only are their tax powers taken away, even those on which they can levy, State governments exercise control in various ways. They have practically no powers of borrowing either and are then forced to rely more and more on grants. Increasing dependence on the State subventions/grants has on the other hand led to lack of accountability and restraint on the part of the municipalities in the matter of spending. According to advocates of this view, the proper remedy therefore lies in giving constitutional status to the urban local bodies and providing them with adequate powers and functions and leaving them alone to make use of the powers invested in them. For grants, there should be a constitutional body such as the Finance Commission to see that funds are devolved to the municipalities on equitable and sound principles taking due note of the need to reward tax effort and punish laggards. For this purpose, while it may not be desirable to give them a "coordinate status" with the State, a constitutional protection of the autonomy and democratic functioning of the municipalities is, on this view, absolutely essential.[1] In other words, more powers should devolve to the municipalities under the constitution.

III. Case against devolution

On the face of it the case for conferring constitutional recognition and guarantee of independence or autonomy with assurance of periodic election, and a clear specification of powers and functions as separate entities though not as a third tier of the government, is irrefutable. However, the fact remains that the experience with elected

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1. A. Datta, "Constitutional Status of Local Government in India" (IIPA, 1986)

municipalities in India has not been uniformly encouraging. Many of the municipal bodies were known to be thoroughly inefficient and have been notorious for corruption. Corruption and inefficiency of the Calcutta Corporation, one of the oldest among the municipal bodies in the country, is a byword among the citizens of the city of Calcutta. It is this - the utter mess prevailing in the municipalities - which presumably impelled the State governments in most instances to supersede the elected bodies and run them with civil servants responsible to their respective State governments. While there is no systematic study to show whether supersession has helped to improve matters, available evidence provides no hard basis either for believing that elected municipalities in general do better than the State-administered ones. Information gathered by the NIUA through its surveys seems to indicate that there is no relationship between effort towards resource raising or level of services provided and the character of the municipalities (that is, whether elected or State-run). As Table 4 will show, the level of services as reflected by per capita ordinary expenditure is below the all-India average in several States where the majority of the municipalities have elected councils. In West Bengal which is having elected municipalities for quite some time, per capita tax revenue is one of the lowest (barely Rs. 16 as compared to an all-India average of Rs 82 vide Table 5). In Madhya Pradesh which has few elected councils in the municipalities, the comparable figure is Rs 43. On the other hand, Orissa with a majority of municipalities elected, has an average per capita revenue of Rs. 87. Dependence on external funds is not markedly different among elected municipalities as compared with the administered ones. As already pointed out, in West Bengal even with regular elections of the municipal councils this dependence shows no sign of abating. Recent developments in West Bengal frustrating the efforts of the expert body set up by the State Government for revision of ratable values of properties (the "Central Valuation Board") should dispel any illusion the election provides a panacea to all municipal evils.

In this situation, it is doubtful if devolution of more powers to the municipalities or holding elections regularly is going to make such difference. Reservation about the wisdom of devolving more tax powers with municipalities is strengthened by the lack of effort on the part of the municipalities in other States too in the exercise of powers already with them. For instance, in Maharashtra the revenue from profession tax remained at less than a crore as long as it was left to be collected by the municipalities. Collections from this source shot up to nearly Rs 100 crore after it was taken over by the State Government. In Kerala, revenue from entertainment tax which is collected by local bodies does not compare well with that realised in neighbouring States like Karnataka and Kerala has mostly elected municipal councils. Obviously, devolution of more powers or holding of elections provide no guarantee that the powers will be used to the required extent.

There is also reason to think that devolution of more fiscal powers to municipalities may result in accentuation of the crisis faced by the poorer municipalities, that is, those which do not have a rich tax base to draw upon. It is noteworthy that municipalities of the Class I category (population between 5 to 10 lakh) have a higher proportion of grants in their revenue than the smaller ones (Table 6). Given this reality only a system of pooling of tax revenue/revenues earmarked for the municipalities and of devolution of funds through grants on an equitable basis would help to equalise the level of municipal services. Greater devolution of powers to local bodies would help only the municipalities endowed with a potentially good tax base and leave the poorer ones in a helpless position.

These presumably are the reasons for which all the world over municipal bodies are provided with grants on a substantial scale from the Central or immediately higher levels of Government. But grants have their problems too as the U.K. experience amply shows, viz., they tend to undermine the accountability of municipalities for their spending and severely erode their incentives for raising resources on their own.

IV. The Issue of Accountability : UK Experience

Plagued with the problem of mounting spending by the local governments and the growing dependence on grants, the U.K. government brought about a sweeping reform in the system of financing local government expenditure over the last two years. The centre piece of the reform is the introduction of a "Community Charge", a flat-rate poll tax on adults over the age of eighteen, replacing the property tax on non-commercial properties ("the domestic rates" as they were known). As with domestic rates, determination of the level of the community charges will remain under the control of local authorities. The other important component of the reform is the withdrawal of local control over the level at which non-domestic rates are to be fixed. Henceforth there will be a uniform national "poundage", which will be an earmarked national tax, the collections from which will be distributed as a per capita grant to local authorities. Under Central Government's contribution to local authorities, spending will be provided as fixed "Block Grant", which will be invariant to the level of local spending.

The main objective underlying these reforms is stated to be to bring about a measure of "accountability" for local government spending, which was "blurred and weakened by the complexities of the national grant system and by the fact that differences arise among those who vote for, those who pay for, and those who receive local government service".[2] These reforms followed

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2. Paying for Local Government (Green Paper brought out by U.K. Government in 1986).

unsuccessful attempts to reduce local authority spending in the initial years of the present Conservative government. The withdrawal of local authority control over business ratepayers implied a severe reduction in the tax base on which the local authorities could draw. The new arrangement, it was argued, would make for accountability in that additional local spending will now have to be paid for in full by the residents through a tax on individuals, "with clear and direct incidence, rather than partly through taxes on business, where the final incidence may be less widely perceived and may be borne in part by residents of other authorities".[3] The institution of "block grants" in a lumpsum unrelated to the actual level of local spending (though based on the Central government's assessment of local needs) would, it is thought, reinforce the relationship sought to be restored between local spending and local taxation. The rationale underlying the new system of block grant with any increase in spending at the margin to be met by local taxation is explained succinctly in the following words of C.D. Foster, a noted authority on Local Finance:

> ".....from an efficiency point of view it is not the average, but the marginal cost falling on the local population which matters. By fixing grant in advance, the Green Paper proposals oblige authorities to cover the total cost of extra spending from local sources. That is likely to be a much more effective disincentive to spend than reductions in the average proportion of spending met by grant.."[4]

The reforms of local government finance in the U.K. cutlined above raised misgivings among experts on ground of equity as it was felt that the poll tax would cast a much larger burden on the poorer sections than before and also on efficiency grounds. The claim that the new system would

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3. Stephen Smith, " Should UK Local Government be Financed by a Poll Tax?", Fiscal Studies (London, February 1988).

4. C.D. Foster, "Reforming Local Government Finance", Public Money , Vol.6.

introduce accountability was also doubted on the ground that "the level of spending chosen by local authorities is influenced quite substantially by the amount of lump sum grant received from Central government. Thus the formally efficient local spending decision can never (i.e., the granting authority) exert an influence, as long as there is some central grant in it".[5] It would perhaps be futile to expect that when nearly 75 per cent of the local spending is met out of grants, which is the net result of the reforms, the requirement that any marginal increase in spending must be met out of own resources would help restore accountability.

The withdrawal of local business rate and its substitution by a nationally collected tax has been assailed on the ground that it snaps the link between liability to pay and benefits received - the benefit principle, in short - which forms the keystone of the new approach.

The point to note is that, ironically, while aiming to introduce accountability the U.K. reforms have enlarged the grants component in local revenue. The fact is that given the cost of providing civic services and the narrowness of their tax base, grants on a large scale cannot be dispensed with. While there is need to look for new tax sources, municipalities may be in a position to make full use of their tax powers due to various factors, like lack of skilled personnel and local political pressure. Besides, there are obvious efficiencies in the collection of certain taxes at higher levels of government (e.g., income tax and sales tax). Hence a system of grants has to stay. It is also not certain that intergovernmental grants are always substitutive and not stimulative in respect of local tax effort.[6] Moreover,

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5. J.G. Gibson, "The Reform of British Local Government Finance : An Evaluation" in Policy and Politics , July 1987.

6. Roy W. Bahl and Johannes F. Linn, "Intergovernmental Transfers : Flows and Impacts" in Selected Readings in Urban Financial Resource Mobilisation (World

grants can be designed in several forms and there are ways in which they can be designed as to act as stimulative of local governments' tax effort. The "revised grants formula" recommended by the West Bengal Municipal Finance Commission shows how this can be attempted in India.

At the same time it would be unwise to take away the powers of the municipalities and make them depend exclusively on grants, however carefully designed. Above all, the choice of services and the responsibility for paying for them must rest as far as possible with the beneficiaries. Hence the need for having the municipal councils elected periodically and for allowing them fiscal powers which they can exercise well even with the limited administrative resources at their command. The unhappy experience with elected councils in the past should not be allowed to overshadow their merit.

V. Concluding remarks

Solution to the dilemma posed by the need to devolve more powers to local authorities and decentralised in order to foster initiative and responsibility at local level on the one hand and considerations of equity and efficiency on the other would seem to lie in:

> According constitutional recognition to municipal bodies with assurance of periodic elections and full powers in respect of tax which are best administered locally, assessing the revenue and expenditure gap of the municipalities on a normative basis to enable them to provide the basic civic services reasonably well and evolving a system of devolution which would be stimulative rather than substitutive of local revenue effort (This calls for setting up appropriate institutions like municipal finance commission. However, the channel of devolution has to be the States as assessment of local needs by the Central Government is simply impracticable.);

Bank, 1987).

Strengthening the administration capacity of local bodies in all possible ways (Ways of making property tax assessments standardised and less amenable to subjective judgment should be explored); and

Introducing the benefit principle (user change wherever possible) leaving the task of redistribution and care of the poor to higher level governments. The scope for extending this approach is larger than what is otherwise assumed. The recommendation of the National Commission on Urbanisation for a two-tier local government, the lower unit being a ward or "mohalla" might be helpful in implementing the user principle.

However, it should be recognised that there are limits beyond which the benefit principle cannot be pushed further as several of the services provided by the municipalities are in the nature of "public good" with inherent free rider possibility (since it may not be possible to prevent those who do not pay from enjoying the benefit). Besides, given the stark inequalities, a system of local finance based only on user principle will not be acceptable and may cause genuine hardship. A measure of progressivity in the distribution of the burden of financing local governments cannot therefore be given up altogether. Overall progressivity in municipal financing can be achieved if the property tax is assessed properly. The accent therefore should be on strengthening the property tax while tax on non-domestic properties might be oriented more to benefits received.

It will not be fair to presume that the tasks set out above are beyond the capability of elected bodies or that they will act irresponsibly. The functioning of democracy in our country despite its shortcomings shows that the people do exercise their right in public affairs to the best of their judgment and accountability does operate even though a bit loudly at times. If the elected councils have acted in what might be regarded as responsible manner, it is because of lack of incentives and disincentive with the system. It is possible to build such incentives and disincentive into the system of municipal finance.

It is also pertinent to note that in our situation accountability has another dimension, viz., the responsibility for spending. Cynicism about the political powers is bred largely by the fact that quite often public funds are usurped by local politicians. But that argues for strengthening local people's vigilance and not taking away their powers to exercise control over political masters through periodic elections. One reason why the political process has not been able to exercise such control is lack of awareness and information among the people. It cannot be overemphasised that democracy can work only where the people are well informed. Periodic elections are a process which help dissemination of information and creating awareness. What is needed is to strengthen that awareness and the collective will to enforce accountability of elected representatives. In the context of municipal financing, the best way to enforce accountability is to provide sufficient fiscal powers to the local bodies and to evolve a suitable grants system with built-in incentives from the next higher level of government that is the States in our case. The way to make incentives and disincentive effective is to involve the people and not excluding them from a say in matters which concern them.

TABLE 1

Revenue Structure of Municipal Authorities in India

State	Tax			Non-tax			Total own revenue			Grants, assigned taxes and borrowings		
	1975-76	1979 80	1986 87	1975-76	1979 80	1986 87	1975-76	1979 80	1986 87	1975-76	1979 80	1986 87
Andhra Pradesh	63	50	26	18	9	29	91	59	50	19	41	50
Assam	53	35	29	35	11	62	99	46	91	11	54	9
Bihar	37	50	30	17	10	17	53	60	47	47	40	53
Gujarat	24	75	64	69	7	11	93	82	75	7	18	25
Haryana	64	75	50	28	15	21	92	94	71	8	6	29
Himachal Pradesh	70	78	32	26	12	30	96	90	61	4	10	39
Jammu & Kashmir	49	34	34	49	6	7	98	40	41	2	60	59
Karnataka	80	34	55	18	11	20	97	45	75	3	55	25
Kerala	72	70	63	18	17	20	91	87	84	9	13	16
Madhya Pradesh	78	26	42	17	10	14	95	36	56	5	64	44
Mahsrashtra	69	84	60	16	6	7	85	90	66	15	10	33
Orissa	51	47	57	23	12	8	74	59	65	26	41	35
Punjab	79	89	79	19	8	13	98	97	92	2	3	8
Rajasthan	78	82	75	22	8	11	100	90	86	Neg	10	14
Tamil Nadu	65	59	25	32	13	35	97	72	60	3	28	40
Uttar Pradesh	60	65	53	21	12	9	81	77	62	19	23	38
West Bengal	60	40	33	11	10	4	71	50	37	29	50	63
ALL INDIA	63	65	54	24	10	13	87	75	68	13	25	32

Sources: Finance Commission (1979), NIUA (1983 and NIUA (1989).

TABLE 2

Finances of Municipal Authorities : West Bengal

(Rs. 10 million)

Year	Own Source Revenue			Revenue expenditure	Revenue gap (4-3)	Gap as per cent of expenditure
	Property tax	Other taxes	Total taxes			
	1	2	3	4	5	6
1965-66	7.66	1.93	9.59	12.28	2.69	22
1970-71	10.64	1.81	12.45	19.78	7.33	37
1975-76	14.10	4.69	18.79	27.13	8.34	31
1980-81	18.94	7.48	26.42	53.23	26.81	50
1981-82	23.86	10.35	34.21	64.75	30.54	47
1982-83	25.86	8.85	34.51	68.92	34.41	50
1983-84	28.29	10.24	38.53	82.32	43.79	53
1984-85	30.35	4.84	35.19	84.21	49.02	58

Source: T.K. Banerjee (1986) "Resource Mobilisation in Prospect", paper presented at the Seminar on Calcutta's Basic Development Plan : In Retrospect.

TABLE 3

Estimated Resource Gap at 1986-87 Prices, Using the Expenditure Norms Laid Down by the Zakari committee

State	Revenue expenditure norms (Per capita per annum) (Rs.)	Estimated revenue GDP as per cent to revenue income	
		1986-87	1994-95
Andhra Pradesh	204.74	71	117
Assam	204.74	1742	4043
Bihar	204.74	947	1318
Gujarat	204.74	41	27
Haryana	204.74	77	135
Jammu and Kashmir	204.74	29	135
Karnataka	204.74	24	145
Kerala	204.74	225	266
Madhya Pradesh	204.74	100	187
Maharashtra	204.74	39	42
Manipur	204.74	3560	5125
Meghalaya	204.74	164	215
Orissa	204.74	58	96
Punjab	204.74	79	51
Rajasthan	204.74	160	261
Tamil Nadu	204.74	122	163
Tripura	204.74	3	29
Uttar Pradesh	204.74	158	235
West Bengal	204.74	310	692
Goa	204.74	-	14
INDIA		117	140

Source : NIUA

TABLE 4

Per Capital Income and Expenditure of Municipal Bodies (1986-87)

State	Per Capita Urban Income#	Per Capita Revenue Expenditure	Per Capita Revenue Income	As per cent to Urban Income	
				Revenue Expenditure	Revenue Income
1	2	3	4	5	6
Andhra Pradesh	5218.59	116.66	67.09	2.24	1.29
Assam	8941.11	15.31	10.16	0.17	0.11
Bihar	5540.48	34.04	36.20	0.61	0.65
Gujarat	6515.80	246.87	192.74	3.79	2.96
Haryana	8841.74	10.52	81.51	1.14	0.92
Himachal Pradesh	21620.26	392.65	276.65	1.82	1.28
Jammu & Kashmir	4879.87	76.25	49.77	1.56	1.02
Karnataka	4520.16	141.45	92.19	3.13	2.04
Kerala	7071.47	86.47	55.25	1.22	0.78
Madhya Pradesh	4335.42	133.43	57.82	3.08	1.33
Maharashtra	7398.26	294.12	224.74	3.98	3.04
Meghalaya	6050.00	76.81	31.67	1.27	0.52
Orissa	5102.57	130.96	100.11	2.57	1.96
Punjab	8573.27	186.05	190.74	2.17	2.22
Rajasthan	5020.41	71.72	70.32	1.43	1.40
Tamil Nadu	6412.84	119.61	63.42	1.87	0.99
Tripura	6393.00	178.22	10.13	2.79	0.16
Uttar Pradesh	6065.50	90.09	51.00	1.49	0.84
West Bengal	6397.29	34.41	18.40	0.54	0.29
Goa	3874.92	122.43	91.05	3.16	2.35
ALL INDIA	5289.38	143.14	102.07	2.71	1.93

Source for columns 3and 4: NIUA (1989)
Rest computed

\# Non-primary sector SDP divided by urban population.

TABLE 5

Per Capita Tax Revenue Incidence, 1986-87

(Rs.)

States	**Per capita Tax Revenue**
Andhra Pradesh	35.33
Assam	3.28
Bihar	5.96
Gujarat	165.41
Goa	46.48
Haryana	57.61
Himachal Pradesh	142.31
Jammu and Kashmir	40.89
Karnataka	67.76
Kerala	41.90
Madhya Pradesh	43.06
Maharashtra	199.85
Manipur	0.16
Meghalaya	23.00
Orissa	87.52
Punjab	163.51
Rajasthan	61.05
Tamil Nadu	26.73
Tripura	5.33
Uttar Pradesh	43.28
West Bengal	16.53
ALL	81.80

Source: NIUA

TABLE 6

Sources of Revenue in the Sampled Municipal Bodies, 1986-87

Size class	Total revenue income (.000 Rs.)	% Share to total income				
		Tax revenue	Non-Tax revenue (shared revenues)	Assigned taxes	Grants in-aid	Others
I	1925881.8	46.7	17.1	6.4	22.2	7.5
II	1585195.9	51.7	8.8	5.2	17.6	16.7
III	942727.6	59.4	12.7	9.2	10.8	7.9
IV	534820.0	63.9	7.1	8.5	11.3	9.3
V	614004.9	49.5	23.2	3.4	17.8	5.9
VI	322595.4	73.1	9.6	-	10.4	7.0
VII	294139.0	73.2	12.5	0.5	9.4	4.5
ALL	6219366.60	54.3	13.5	5.8	16.7	9.7

Source :NIUA

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